

Finance Advisory Committee

September 14, 2006

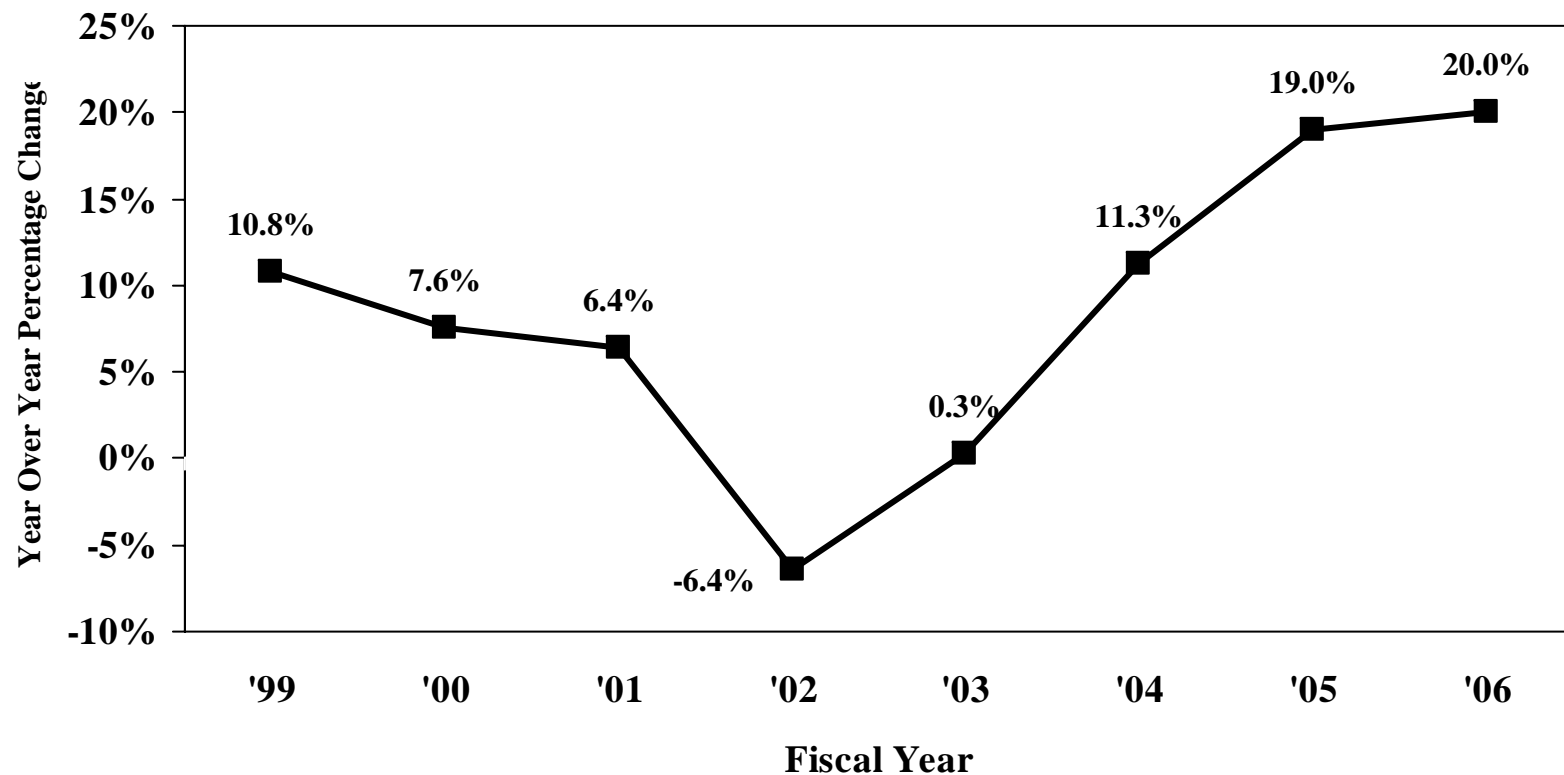
JLBC

FY 2006 Revenue Collections

2nd Year of Extraordinary Growth

- Baseline revenue collections for FY 06 were 20% over FY 05 collections.
- Highest two-year growth in at least the last 35 years.

General Fund Baseline Revenue Growth Rate

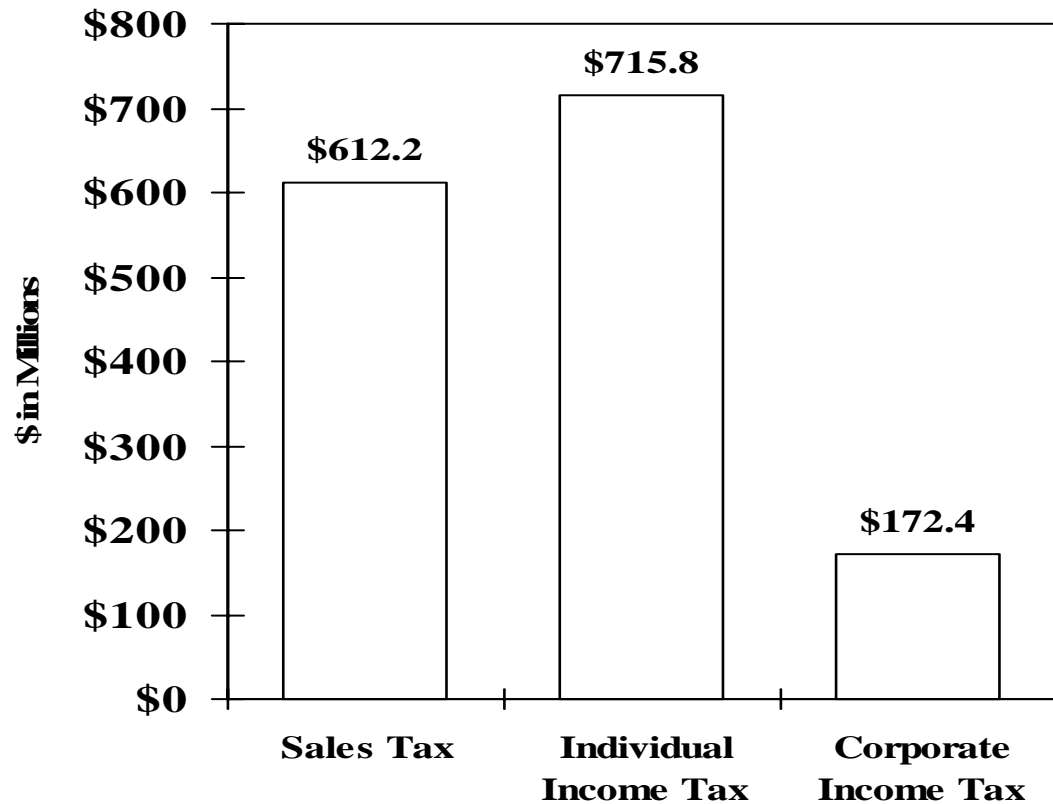


* Excludes statutory and one-time changes.

FY 2006 Major Tax Collections were \$1.5 Billion Higher than Prior Year

- All Three Major Categories Were Strong

- 16.7% - Sales Tax Growth
- 24.1% - Individual Income Tax Growth
- 24.6% - Corporate Income Tax Growth



FY '06 above FY '05

FY 2006 Revenue Collections

Factors Behind High Growth

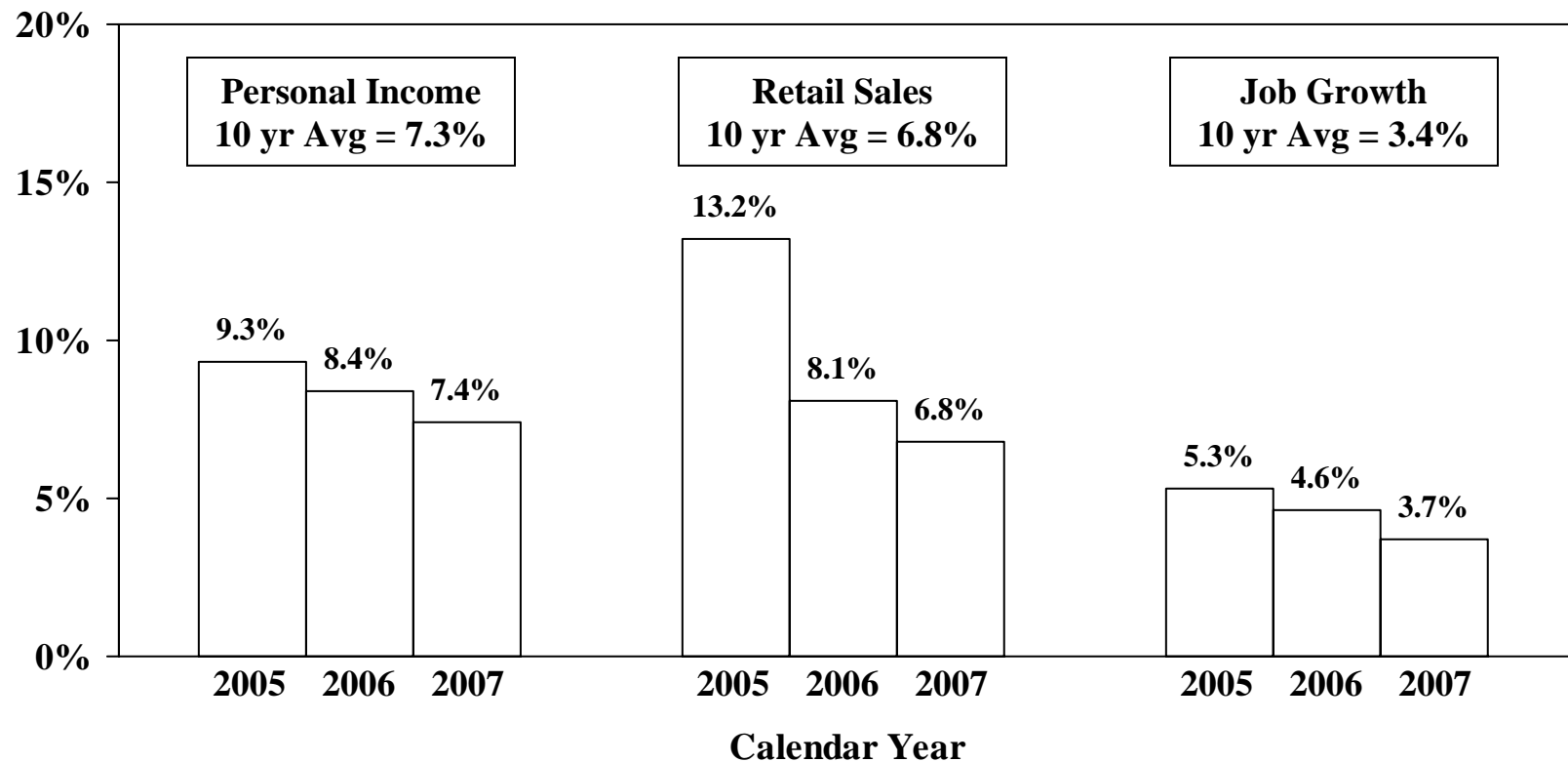
- Strong construction industry, both residential and commercial.
 - Arizona building permits up 21% in calendar 2004, leveled off in 2005 – reflected in FY 2006 revenue collections.
- Business profitability – impacted both corporate and individual income tax collections.
- Real estate – market began to cool in mid-2005, however strong conditions up to that point affected FY 2006 collections.
 - High level of capital gains.
 - Real estate industry income.

What is the Current Economic Outlook?

- Elliott's Presentation Addressed National Economy**
- Arizona Economic Indicators Show Mixed Picture**

- Business Conditions Index's 2006 average of 60 points is below 2004-2005 average of 65.5, but still above neutral point of 50.
- Leading Index negative in 5 of first 6 months of 2006.
- Business Leaders Confidence Index declined 8.1 points to 49.8 in 3rd Quarter.
 - Index has fallen below neutral point of 50, indicating a possible economic slowdown.

While Arizona Blue Chip Forecasts A Slowdown in CY 2006 and CY 2007, Projections Remain Near Historical Averages

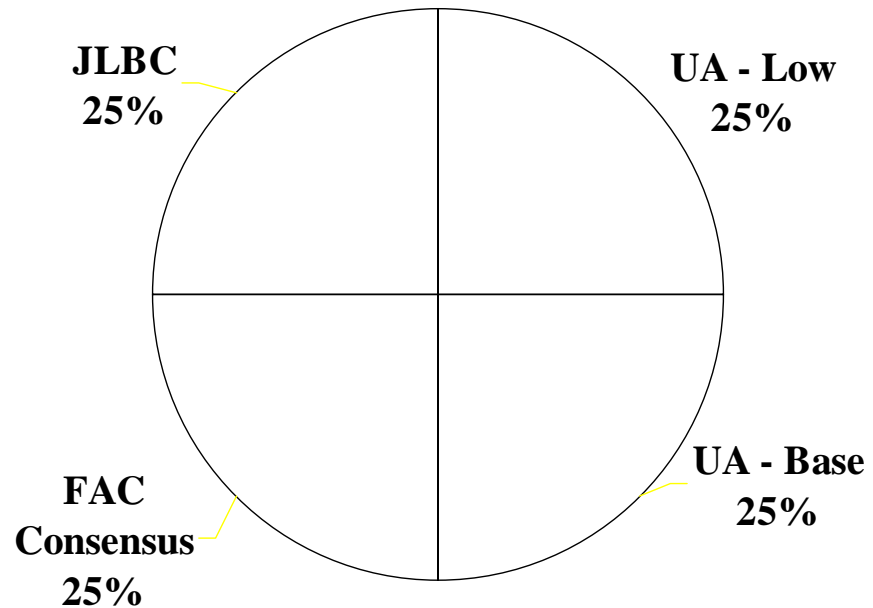


FAC Forecast is a Component of “Big 3” General Fund Revenue Consensus Estimate

UA Model Represents 50% of the Forecast

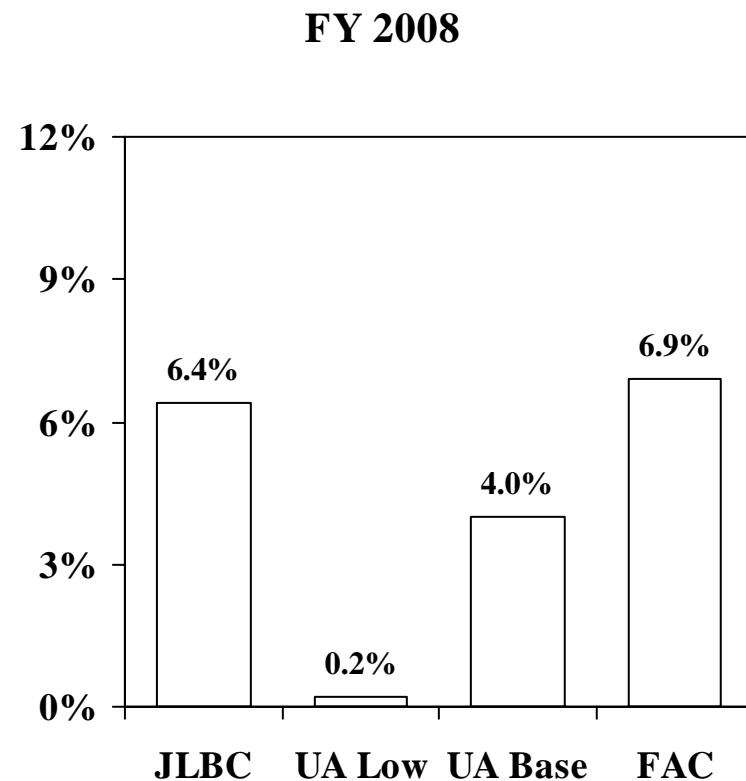
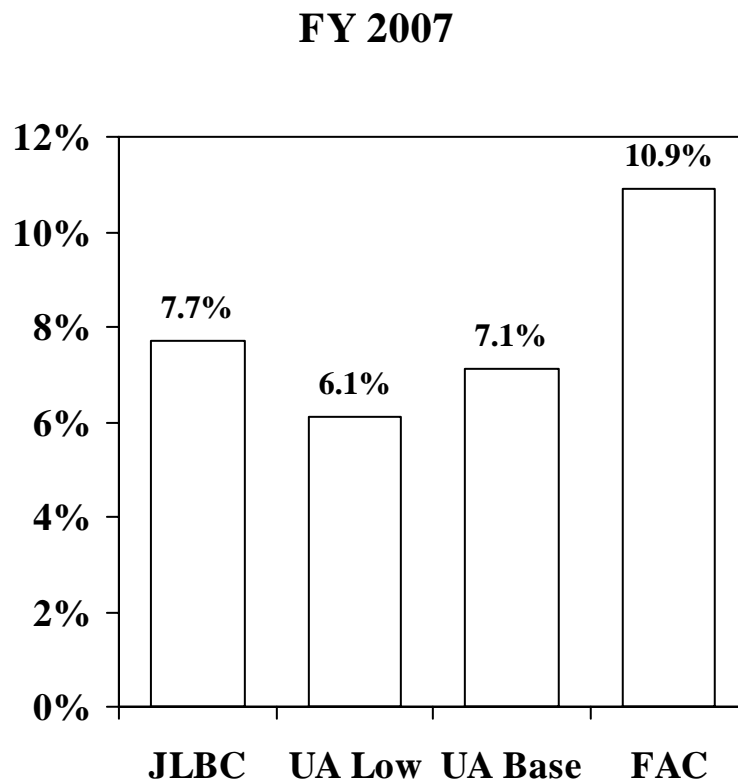
**Big 3 forecast equally
weights:**

- **FAC average**
- **UofA model - base**
- **UofA model - low**
- **JLBC staff forecast**
- **Remaining revenues (6% of total) are staff forecast**



“Big 3” Forecast Growth by Input

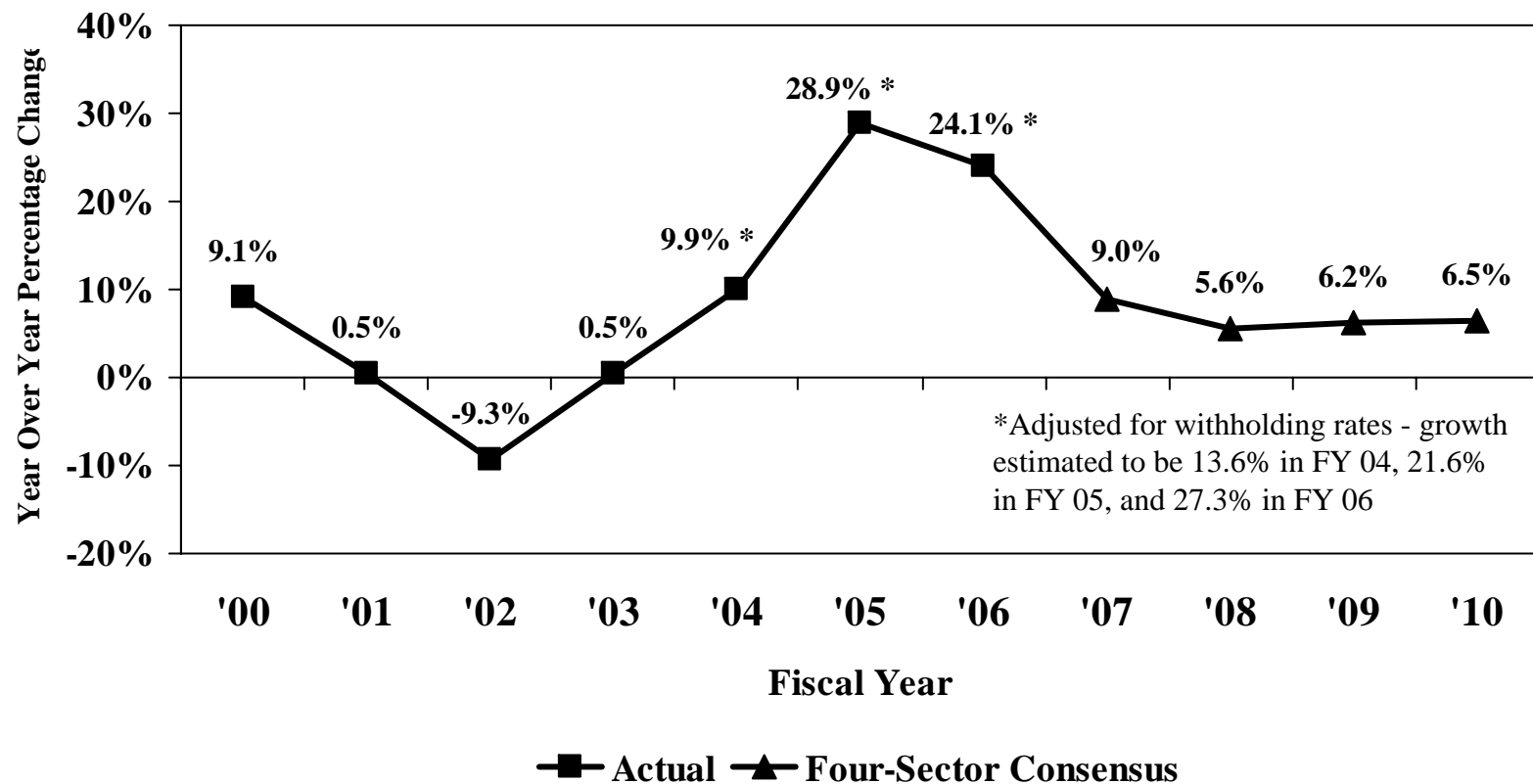
- UA Models More Cautious Than Other 2 Inputs, Especially in FY 2008



Individual Income Tax Growth Rate

FAC Consensus Higher Than 4-Sector Forecast

11.7% for FY 2007 and 7.2% for FY 2008



FY 2006 Actual = \$3.7 Billion

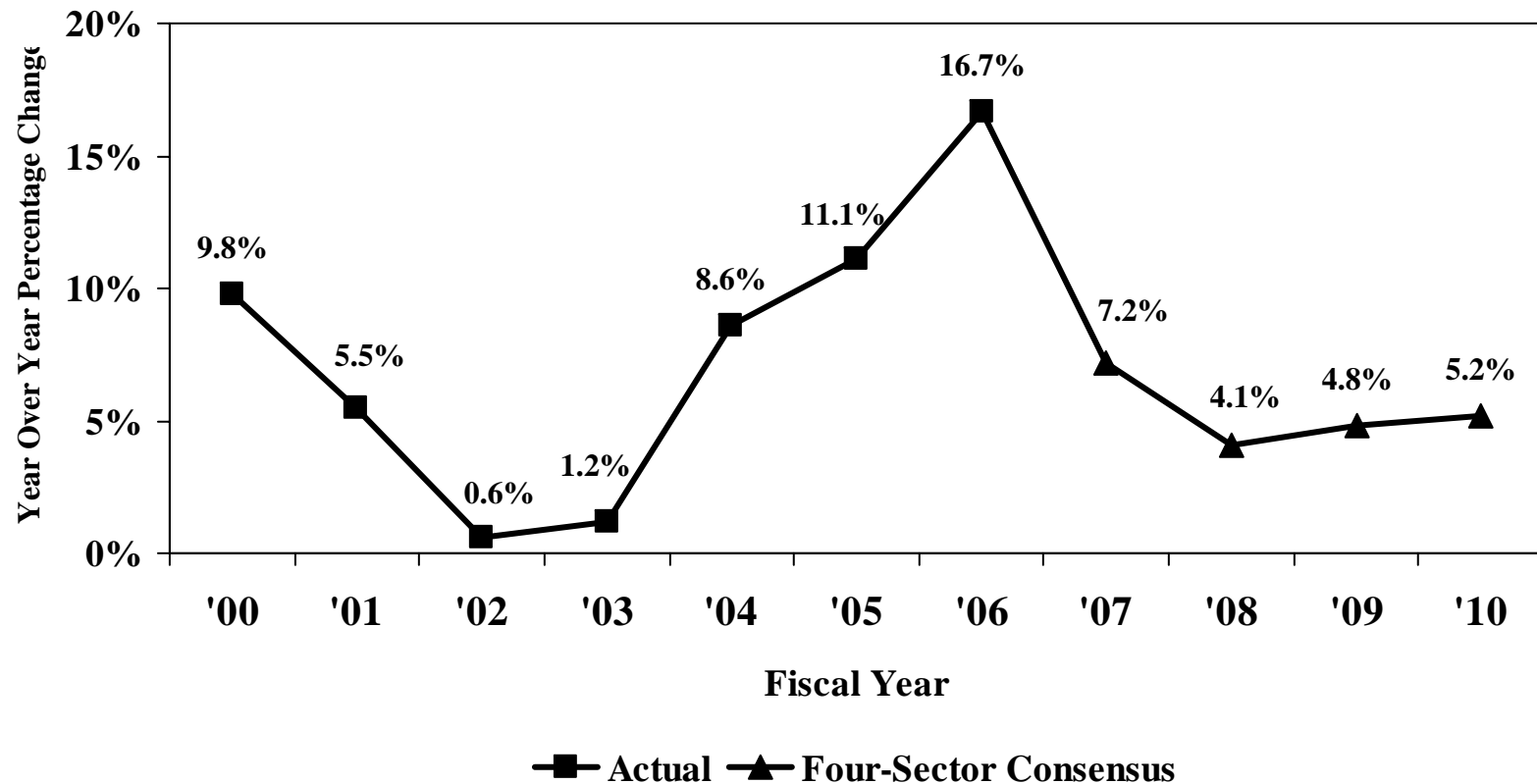
FY06 Individual Income Tax Growth of 24.1% Fueled By A Strong Arizona Economy

- Job growth of 5.3% and average wage increase of 5.1% explains less than 50% of this growth.
- Remainder attributable to:
 - Increased small business profitability as evidenced by a 14.7% growth in proprietors' income.
 - Large but still unknown amount of capital gains.

Sales Tax Growth Rate

FAC Consensus Higher Than 4-Sector Forecast

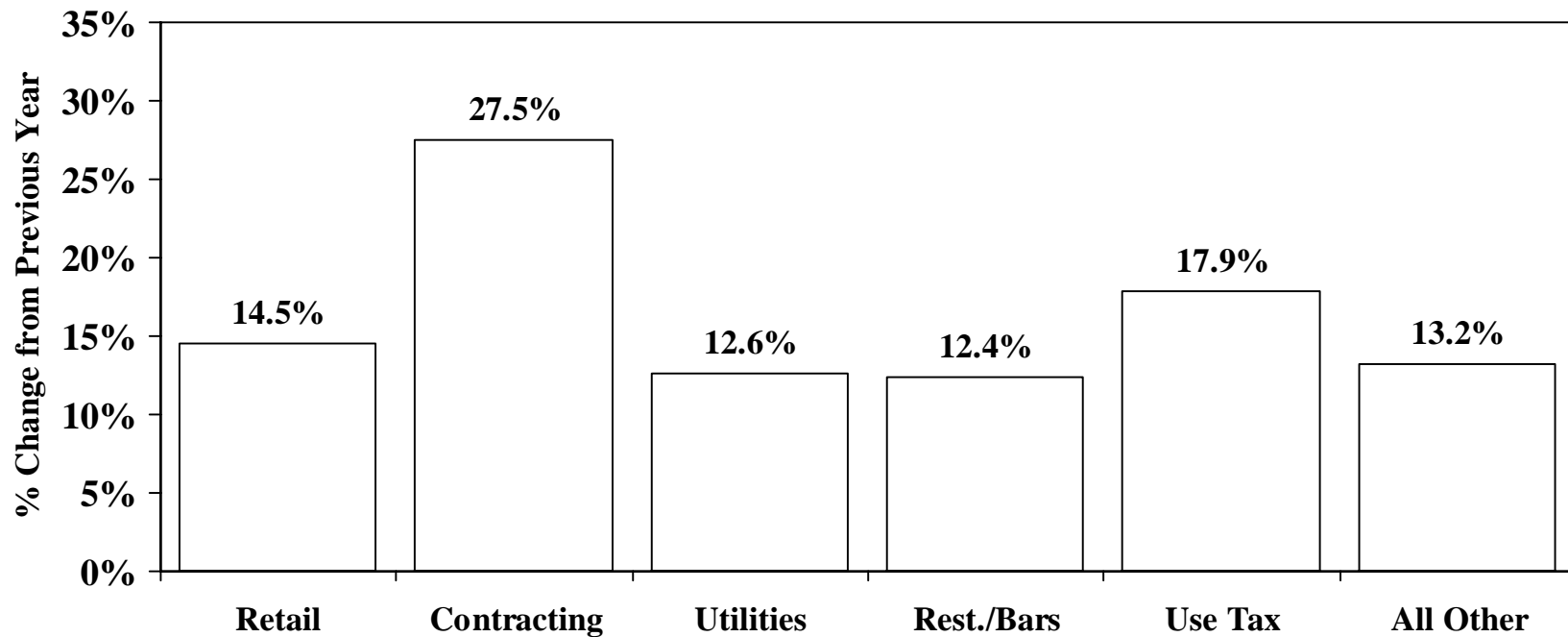
10.1% for FY 2007 and 7.3% for FY 2008



FY 2006 Actual = \$4.3 Billion

FY 2006 Sales Tax Collections Were Strong Across All Major Categories

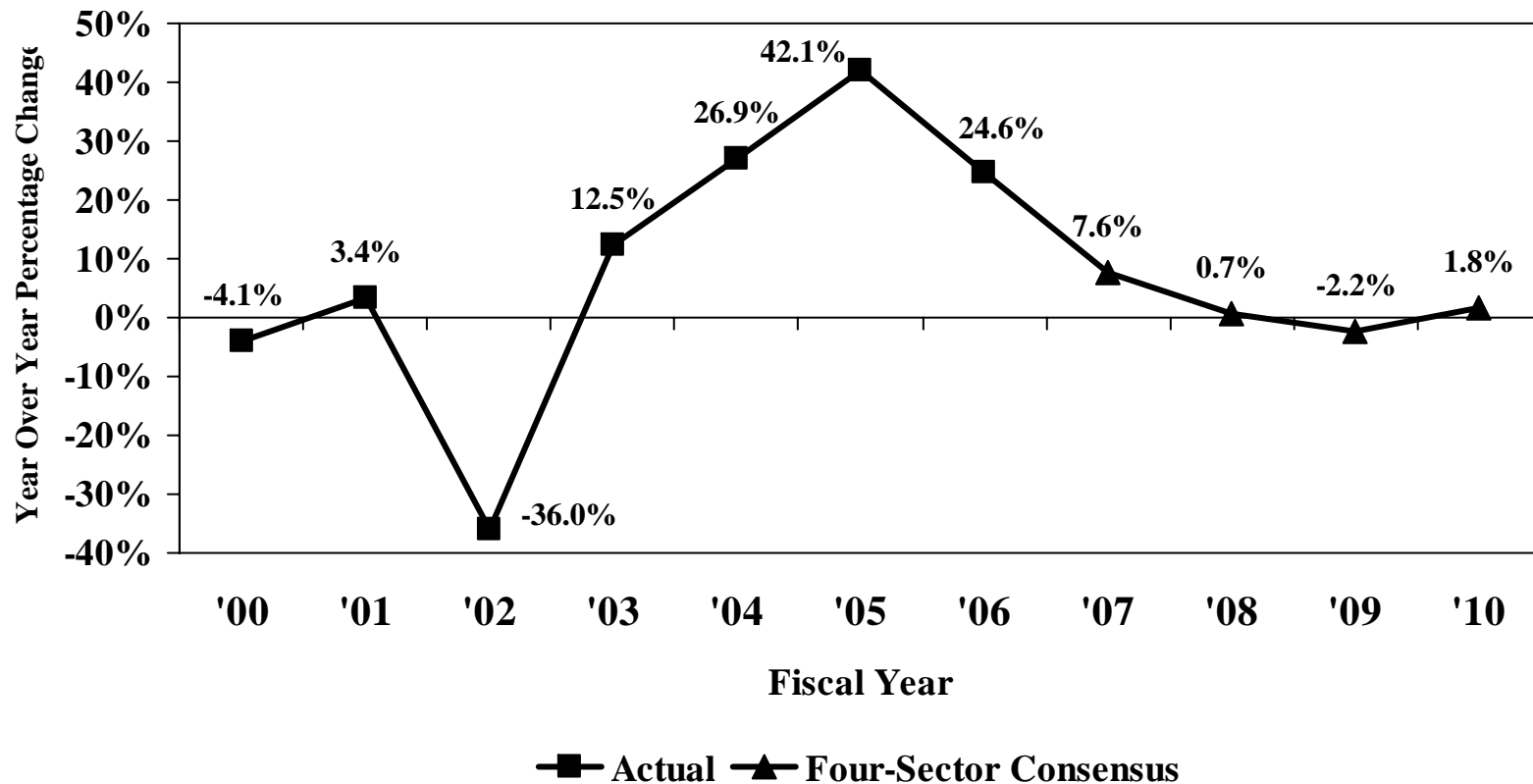
- Overall Growth was 16.7%



Corporate Income Tax Growth Rate

FAC Consensus Higher Than 4-Sector Forecast

11.6% for FY 2007 and 3.6% for FY 2008



FY 2006 Actual = \$874 Million

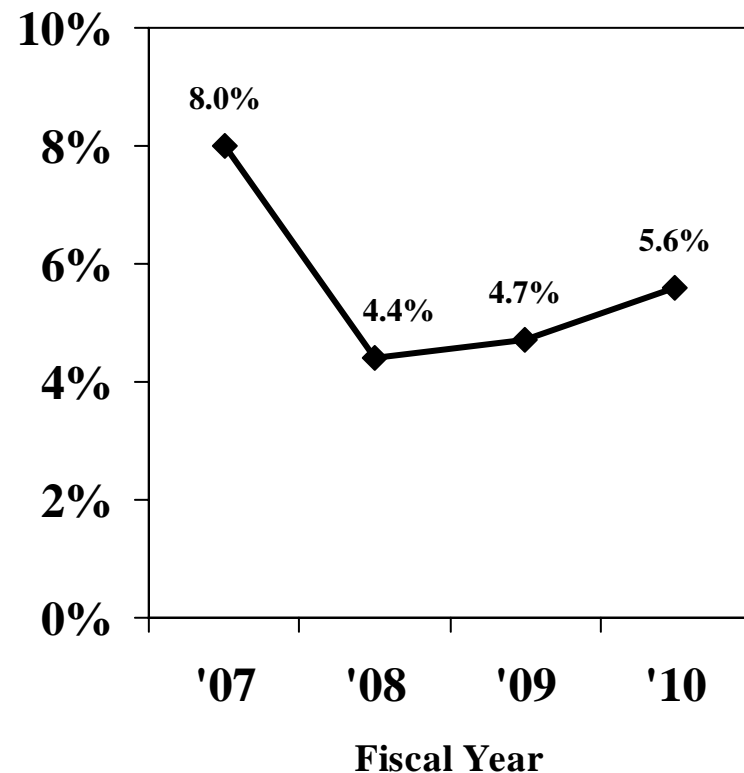
Exceptional Growth Pushed Corporate Tax Revenue to Record Levels in FY 2006

- U.S. corporate profits soared by 19.1% in 2004, 12.5% in 2005, and 19.7% in the first half of 2006.
- Sarbanes-Oxley accounting reform induced better compliance and fewer tax-avoidance strategies.
- 2004 federal law may have led to a one-time repatriation of more than \$350 billion in U.S. corporate profits.

Big 3 Forecast Growth

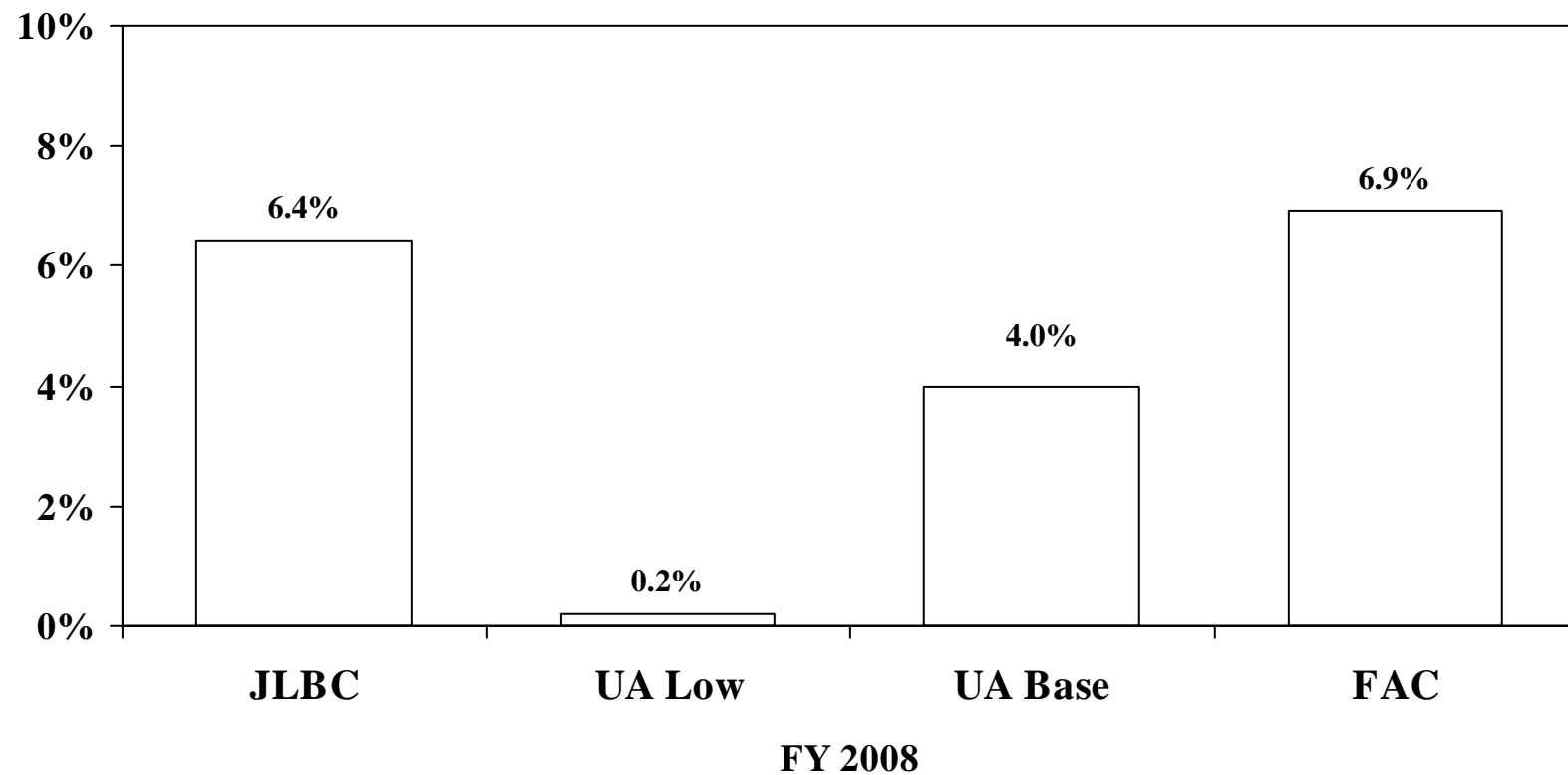
Four-Sector Consensus Forecast Has Growth of 8.0% in FY 2007 and 4.4% in FY 2008

- '07 Growth of 8% would be steep decline from 20% in '06, but close to budgeted rate.
- Year to date '07 data is inconclusive.
- '08 Forecast is pulled down by flat growth scenario in the UA-Low Model.
- Without UA-Low, '08 grows by 5.8%.



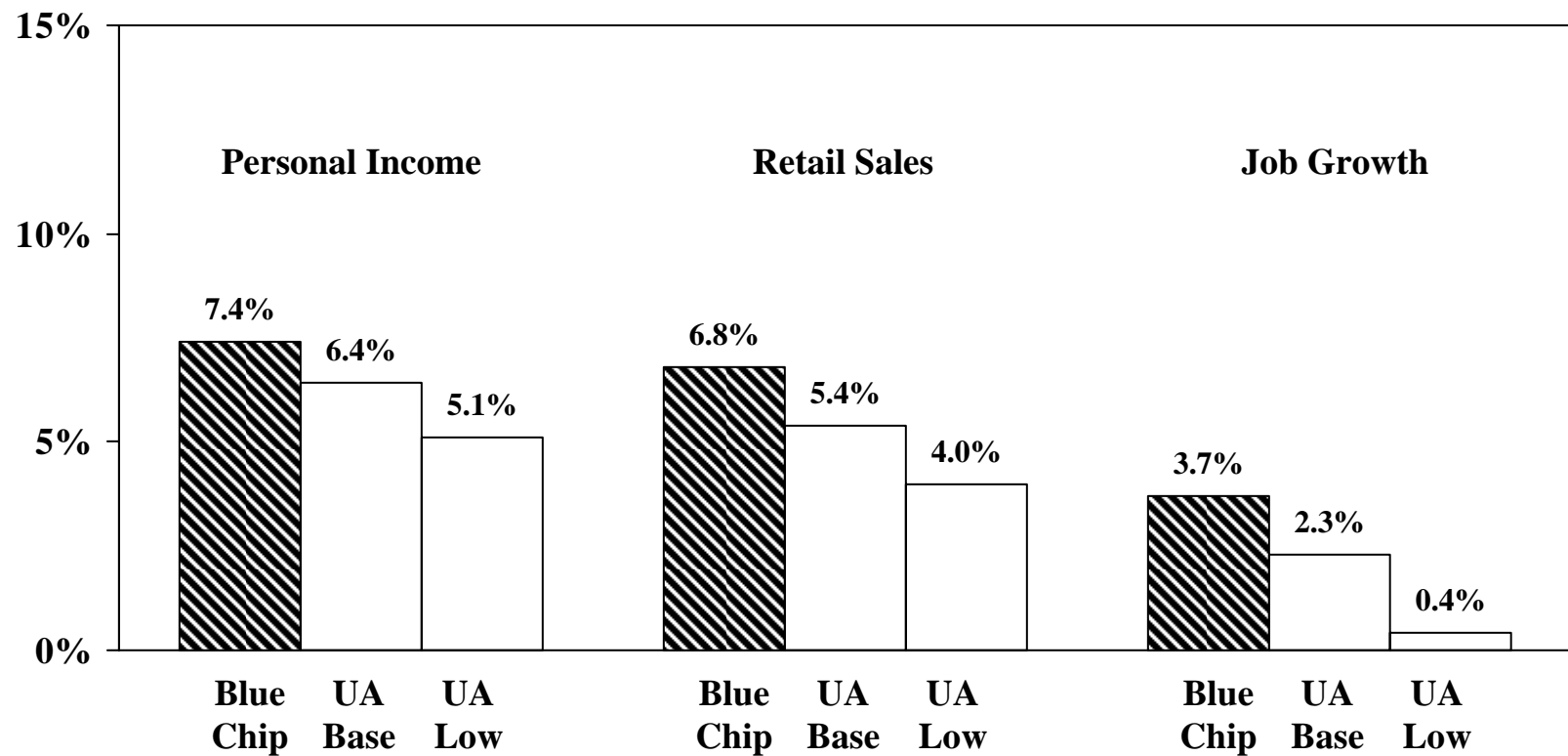
“Big 3” Forecast Growth by Input

- 25% of FY 2008 Consensus is Based on a No-Growth Scenario



What are the Chances for a Flat Revenue Growth Scenario?

- Blue Chip More Optimistic than UA Models for CY 2007



Evaluating the Odds of Flat Revenue Growth - How Does that Compare to the Odds of a Recession?

- National Blue Chip places the odds of a recession at 21% in 2007
 - Based on responses from 55 panelists
 - Top 10 Average 33.1%
 - Bottom 10 Average 9.5%
- Arizona Blue Chip was asked when the next recession would occur in Arizona
 - 13% said prior to 2008
 - 20% said 2008
 - 67% said 2009 or beyond

FY 2007-FY 2010 Quartile Forecast Worksheet

	FY 2007	FY 2008	FY 2009	FY 2010
<u>Sales Tax</u>				
JLBC Forecast (9/7/06)	6.9%	6.5%	6.0%	6.0%
UA - Low (8/06 revision)	5.4%	-0.6%	1.9%	3.7%
UA - Base (8/06 revision)	6.3%	3.2%	5.1%	5.7%
FAC (9/14/06 Survey)	10.1%	7.3%	6.3%	5.5%
Average:	7.2%	4.1%	4.8%	5.2%
<u>Individual Income Tax</u>				
JLBC Forecast (9/7/06)	8.2%	7.1%	6.8%	6.6%
UA - Low (8/06 revision)	7.3%	2.7%	4.9%	5.2%
UA - Base (8/06 revision)	8.6%	5.3%	7.1%	7.4%
FAC (9/14/06 Survey)	11.7%	7.2%	6.1%	6.6%
Average:	9.0%	5.6%	6.2%	6.5%
<u>Corporate Income Tax</u>				
JLBC Forecast (9/7/06)	9.8%	3.0%	2.4%	2.4%
UA - Low (8/06 revision)	4.0%	-6.6%	-13.5%	-3.1%
UA - Base (8/06 revision)	5.0%	2.8%	-2.5%	2.2%
FAC (9/14/06 Survey)	11.6%	3.6%	4.9%	5.7%
Average:	7.6%	0.7%	-2.2%	1.8%
Overall Weighted Average:	8.0%	4.4%	4.7%	5.5%
Overall Weighted Average-3 sector: (exclude UA Low)	8.6%	5.8%	5.8%	6.0%